

Message Text

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ACTION EUR-12

INFO OCT-01 EA-07 IO-10 ISO-00 SP-02 AID-05 EB-07 NSC-05

CIEP-01 TRSE-00 SS-15 STR-04 OMB-01 CEA-01 L-03 H-02

PA-01 PRS-01 USIA-06 CIAE-00 COME-00 FRB-03 INR-07

NSAE-00 XMB-02 OPIC-03 LAB-04 SIL-01 ERDA-05 DODE-00

FEAE-00 FPC-01 INT-05 PM-04 SAM-01 OES-03 /123 W

----- 036170

R 291721Z SEP 75

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 5153

INFO AMEMBASSY BERN

AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

AMEMBASSY LUXEMBOURG

AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY STOCKHOLM

AMEMBASSY THE HAGUE

AMEMBASSY TOKYO

AMCONSUL BELFAST

AMCONSUL EDINBURGH

USMISSION EC BRUSSELS

USMISSION OECD PARIS

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DEPARTMENT PASS TREASURY AND FRB

E.O. 11652: N/A

TAGS: UK, EFIN, ECOM

SUBJECT: OIL PRICE INCREASE - REACTION AND IMPACT

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SUMMARY: OFFICIAL HMG ESTIMATES PUT NET COST OF 10 PERCENT OPEC OIL PRICE INCREASE TO UK TRADE BALANCE AT 270 TO 300 MILLION POUNDS. THE MAIN BURDEN OF HIGHER PRICES IS LIKELY TO FALL ON GASOLINE. THE PRICE INCREASES WILL STRAIN BUT NOT SERIOUSLY ENDANGER THE SUCCESS OF HMG'S ANTI-INFLATION PROGRAM. END SUMMARY.

1. NOW THAT THE UNCERTAINTY OVER THE SIZE OF THE PRICE INCREASE ON IMPORTED OIL HAS BEEN REMOVED, GOVERNMENT REACTION AND ASSESSMENT OF THE ECONOMIC IMPACT ARE BEING ACCORDED WIDE COVERAGE IN THE PRESS. THE FINANCIAL TIMES QUOTES ENERGY SECRETARY BENN AS PUTTING THE BALANCE OF PAYMENTS COST OF THE INCREASE AT ONE MILLION POUNDS PER DAY. HOWEVER, OTHER WHITEHALL SOURCES ARE REPORTED TO TAKE THE VIEW THAT WHILE ANNUAL OIL IMPORT COSTS ARE LIKELY TO RISE BY 330 MILLION POUNDS, HIGHER PRICES FOR RE-EXPORTED PETROLEUM PRODUCTS WILL OFFSET THIS DRAIN BY ABOUT 60 MILLION POUNDS. THESE FACTORS COUPLED WITH THE ARRIVAL IN QUANTITY OF NORTH SEA OIL, EXPECTED TO SUPPLY 10 TO 15 PERCENT OF UK DEMAND IN 1976, SHOULD GO A LONG WAY TOWARD RELIEVING THE NEGATIVE BALANCE OF PAYMENTS IMPACT OF THE OPEC INCREASE.

2. WHILE THE BALANCE OF PAYMENTS MAY BE ABLE TO WITHSTAND THE STRAIN OF AN ADDED 330 MILLION POUND OUTFLOW OF OIL, THE ADVERSE IMPACT OF HIGHER COSTS FOR PETROLEUM PRODUCTS CANNOT BUT BE FELT THROUGHOUT AN ECONOMY TRYING TO BREAK THE BACK OF AN INFLATION CURRENTLY RUNNING AT AN ANNUAL RATE OVER MORE THAN 25 PERCENT. ESTIMATES OF THE DIRECT EFFECT OF THE PRICE INCREASE ON THE RETAIL PRICE INDEX (RPI) ARE OF THE ORDER OF 0.3 - 0.5 PERCENT. WHEN THE RIPPLE EFFECT OF HIGHER OIL PRICES WORKS THROUGH, THE ULTIMATE IMPACT ON THE RPI IS PUT AT ABOUT 0.75 PERCENT. AS WAS THE CASE FOR THE LAST MAJOR OIL PRICE INCREASE IN DECEMBER 1974, THE BURDEN OF THE HIGHER OIL PRICE IS EXPECTED TO FALL MOST HEAVILY ON THE MOTORIST WITH INCREASES OF UP TO 8 PENCE PER IMPERIAL GALLON FOR PREMIUM GAS REGARDED AS PROBABLE. WITH PREMIUM GAS CURRENTLY AT 73 PENCE PER GALLON, SUCH INCREASES ARE LIKELY FURTHER TO WEAKEN A MARKET ALREADY CHARACTERIZED BY INTENSE COMPE-

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TITION WHICH HAS DRIVEN MANY SMALLER RETAILERS TO THE VERGE OF SHUTTING DOWN. THROUGH ITS CONTROL OVER THE SIZE OF PRICE INCREASES THE GOVERNMENT IS LIKELY TO HOLD

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NSAE-00 XMB-02 OPIC-03 LAB-04 SIL-01 ERDA-05 DODE-00

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DOWN THE PRICE OF OIL FOR INDUSTRIAL AND HEATING PURPOSES
SO AS TO MINIMIZE COST INCREASES FOR EXPORT INDUSTRIES
AND THE PUBLIC AT LARGE.
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3. COMMENT: THE 10 PERCENT OIL PRICE INCREASE IS NOT LIKELY TO JEOPARDIZE THE SUCCESS OF THE GOVERNMENT'S ANTI-INFLATION PROGRAM. FORECASTERS AT THE TREASURY AND ELSEWHERE HAVE INCLUDED THE IMPACT OF HIGHER OIL PRICES (USUALLY MORE THAN 10 PERCENT) IN THEIR MOST RECENT ESTIMATES. AS THE ACTUAL INCREASE IS AT THE LOW END OF WHAT HAD BEEN ANTICIPATED, THE FEELING, ACCORDING TO SOURCES AT HM TREASURY AND AT THE NATIONAL INSTITUTE FOR ECONOMIC AND SOCIAL RESEARCH, IS THAT THIS INCREASE CAN BE ACCOMMODATED WITHOUT GREAT DAMAGE. THE MOST CONTROVERSIAL ASPECT IS LIKELY TO BE THE WAY IN WHICH THE PRICE INCREASE IS APPORTIONED AMONG THE VARIOUS PETROLEUM PRODUCTS. A SOURCE AT THE PRICE COMMISSION TELLS US THAT NO DECISION HAS YET BEEN MADE ON THIS ISSUE. THE RULES SUGGEST THAT THE INCREASE SHOULD BE SPREAD EVENLY ACROSS THE RANGE OF OIL PRODUCTS. HOWEVER, AS WAS TRUE LAST DECEMBER, IT IS LIKELY THAT THE ENERGY SECRETARY WILL PUSH FOR THE BULK OF THE INCREASE TO BE PLACED ON THE PRICE OF GASOLINE. THIS ISSUE WILL BE SETTLED SHORTLY AS THE PRICE COMMISSION MUST RULE WITHIN 28 DAYS ON AN APPLICATION FOR A PRICE RISE. COMPLICATING ITS DECISION WILL BE THE TIMING OF THE INCREASE AS ANY INVENTORIES OF CHEAPER OIL WILL BENEFIT FROM THE HIGHER PRICE. ACCORDING TO OUR SOURCE NO DECISIONS AS TO THE TIMING OR THE MAGNITUDE OF THE PRICE INCREASE HAVE YET BEEN TAKEN.

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